vH311

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 216

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE, - - - - Petitioner,

versus

A. M. ANDERSON, RECEIVER, NATIONAL BANK OF KENTUCKY, and
NATIONAL BANK OF KENTUCKY, - - Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

LAWRENCE S. POSTON,
Counsel for Petitioner.
City Hall,
Louisville, Kentucky.

HAL O. WILLIAMS,
Louisville, Kentucky,
Of Counsel.

WESTERFIELD-BONTE CO., INCORPORATED, LOUISVILLE, KY.

SUBJECT INDEX.

ALPHABETICAL TABLE OF CASES.

Federal Statutes.

Kentucky Statutes.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No.__________.

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE, - - - - - - - *Petitioner,*

v.

A. M. ANDERSON, RECEIVER, NATIONAL BANK OF KENTUCKY, AND
NATIONAL BANK OF KENTUCKY, - - - *Respondents.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF THEREON.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Commissioners of the Sinking Fund of the City of Louisville prays that a writ of certiorari issue to review the decree entered on April 12, 1940 (Vol. II, R. 129) by and in the United States Circuit Court of Appeals for the Sixth Circuit in the above entitled cause.

OPINIONS AND DECREES BELOW.

The opinion and decree of the Circuit Court of Appeals for the Sixth Circuit reversing the District Court were rendered April 12, 1940 (Vol. II, R. 130-138, and R. 129, respectively); reported 110 F. (2d) 961.

The action was tried in the District Court for the Western District of Kentucky at Louisville, Judge Elwood Hamilton (now of the Sixth Circuit) then presiding. His opinion filed July 21, 1937, is found in the record (Vol. I, R. 72-88) and reported 20 F. S. 217.

The decree was entered in the District Court October 9, 1937, and is found in the record (Vol. I, R. 100-108).

JURISDICTION.

Jurisdiction is conferred on this Court to review this cause by writ of certiorari by Section 240a of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A. 347a, 43 Stat. 938).

SHORT SUMMARY STATEMENT.

The National Bank of Kentucky, of Louisville, Kentucky, closed its doors after the close of business Saturday, November 15, 1930, insolvent, since which time its affairs have been, and are now, in liquidation, through Federal receivership.

Petitioner, Commissioners of the Sinking Fund of the City of Louisville, is a subsidiary quasi-corporation of the City of Louisville (Kentucky Statute 3010-1, Appendix, p. 31); it has but one function and that is to gather in and conserve funds of the City of Louisville for the purpose

of paying the bonded indebtedness of the City of Louisville as it becomes due and paying the interest thereon as it accrues (Kentucky Statute 3010-8, Appendix, p. 31; Kentucky Statute 3010-9, Appendix, p. 32).

When the Bank closed, Commissioners of the Sinking Fund of the City of Louisville had on deposit with the Bank, deposits aggregating $858,952.48 (F. F., D. C., Vol. I, R. 90), segregated in several different checking accounts. One account was "Commissioners of the Sinking Fund, General Fund," $166,275.99 (Ex. 20, Vol. II, R. 55-56); the other accounts showed allocation to specific series of bonds, for instance, "Commissioners of Sinking Fund, Sewer Bonds, issue of 1907" (Ex. 23, Vol. II, R. 61-62.) (The accounts are Ex. 14 to 23, inc., Vol. II, R. 47 to 62, all offered in evidence, Depo. Zurschmiede, Vol. II, R. 46.)

(The building up of the different accounts is explained in the evidence of Baldauf, Vol. II, R. 12.)

When the Bank closed, it owned in its own name and right, bonds of the City of Louisville of the par value of $169,200.00 (F. F., D. C., Vol. I, R. 93), none of which bonds were then or yet due.

At the time the Bank closed, all of the City of Louisville bonds involved, with the exception of sewer (?) bonds in the face amount of $5,200.00, were pledged to the United States Government as collateral security for deposits in the National Bank of Kentucky, of Postal Savings Funds, aggregating $58,057.71. Such pledged bonds were subsequently redeemed by the Receiver and were then held by him free from any pledge agreement (Stipulation III, Vol. II, R. 91).

At the time the Bank closed its doors, it was carrying the bonds herein involved in its investment ledger sheets,

at a book value of $147,910.00, excluding the value of $5,200.00, City bonds, not pledged (Ex. 13, Vol. II, R. 46; offered Depo., Zurschmiede, R. 44-45).

Between November 17, 1930, when he took charge, and September 15, 1934, the Receiver collected interest on the bonds amounting to $22,900.95 (Vol. I, R. 40). In the fall of 1934, by agreement, all the bonds here involved were sold, *pendente lite,* for $173,512.25, including accrued interest (Vol. I, R. 40), without prejudice to the rights of any party to this controversy. The said sums, aggregating $196,413.20, are being held by the Receiver pending final determination hereof (Vol. I, R. 39-45).

This cause was instituted November 13, 1931, in the District Court of the United States for the Western District of Kentucky, at Louisville, by the petitioner, in equity, to establish its right to set-off as against its deposits, the City of Louisville bonds owned by the Bank.

The District Court allowed the set-off (D. C., Concl. of Law, Vol. I, R. 96-97; Decree, Vol. I, R. 104-107). The Circuit Court of Appeals reversed the District Court and denied the set-off, hence the application for the writ herein.

THE ULTIMATE QUESTION.

Is the Commissioners of the Sinking Fund of the City of Louisville entitled to set-off, as against its deposits, the value of the City of Louisville bonds owned by the Bank, when it failed, or some part thereof?

Incidental and component questions are reflected in Specification of Errors.

SPECIFICATION OF ERRORS.

The United States Circuit Court of Appeals for the Sixth Circuit erred:

1. In rejecting the set-off.
2. In holding that the allowance of the set-off would result in an unfair distribution of the Bank's assets among its creditors.
3. In holding that as the bonds were unmatured at the date of insolvency, this prevented their use by way of setoff.
4. In holding that there was lack of mutuality and in holding that mutuality or interdependency or relation was necessary.
5. In holding that our right of set-off was predicated on the redemption of the bonds, and in failing to distinguish between the equitable right of set-off and the value thereof.
6. In finding that practically all the bonds were pledged on the date on which the District Court adjudged that the Commissioners were entitled to their surrender, and that, therefore, set-off could not be allowed.
7. In finding that when the Bank closed, its City of Louisville bonds were selling above par.
8. In assumptions not supported by the record and not made the basis of findings of fact in the District Court.
9. In assumptions not based on findings of fact in the District Court.
10. In holding that the Commissioners did not in reality assert a right to set-off.

11. In holding that what the Commissioners sought is a forced sale to them of the bonds, selling above par.

12. In finding that the Receiver reacquired the pledged bonds with money that was a part of the Bank's general assets, and in holding that the bonds bear the character of general assets.

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

In rejecting the set-off the Circuit Court of Appeals has rendered a decision:

a. In conflict with applicable decisions of this Court upon a federal question.

1. *Scammon* v. *Kimball*, 92 U. S. 362.
2. *Carr* v. *Hamilton*, 129 U. S. 252.
3. *Scott* v. *Armstrong*, 146 U. S. 499.
4. *North Chicago Rolling Mills Co.* v. *St. Louis Ore & Steel Co.*, 152 U. S. 596.

b. In conflict with the decisions of other circuit courts of appeals on the same matter.

1. *Sinclair Refining Co.* v. *Midland Oil Co.*, 55 F. (2d) 42 (C. C. A. 4).
2. *Gray, Receiver of Monongahela National Bank* v. *School District of the Burrough of Brownsville*, 67 F. (2d) 141 (C. C. A. 3) (Certiorari denied 291 U. S. 660).
3. *Jennings* v. *Gary State Bank*, 74 F. (2d) 100 (C. C. A. 7).
4. *First National Bank of Indianola, Iowa,* v. *Malone*, 76 F. (2d) 251 (C. C. A. 8).

5. *Ellerbe* v. *Studebaker Corporation of America*, 21 F. (2d) 993 (C. C. A. 4).

c. In a way probably in conflict with the decisions of the Court of Appeals of Kentucky.

Kentucky Flour Co., Assignee v. *Merchants National Bank*, 90 Ky. 225.

d. In conflict with its own previous decisions creating confusion in the Circuit.

1. *Central Appalachian Co.* v. *Buchanan*, 90 F. 454.
2. *Geo. D. Harter Bank* v. *Inglis*, 6 F. (2d) 841 (certiorari denied 269 U. S. 576).

e. In which it has so far departed from the accepted and usual course of judicial proceedings as to call for exercise of this Court's power of supervision.

1. Based upon assumptions not supported by the record and not made the basis of findings of fact in the District Court.
2. Based upon assumptions not predicated on findings of fact in the District Court.

f. Which involves principles, the settlement of which is important to the public.

Inasmuch as there are many national banks at this time throughout the country in receivership, and the principles herein involved may arise in various jurisdictions, the questions here urged are not only of interest and importance to the parties to this cause, but to many insolvent national banks now in receivership and their many depositors.

PRAYER FOR WRIT.

WHEREFORE, in view of the foregoing, Your Petitioner, respectfully prays that a writ of certiorari issue out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Sixth Circuit, requiring it to certify and send to this Court for its review and determination a full and complete transcript of the record and all proceedings had in this case numbered and entitled on its docket No. 7969, A. M. Anderson, Receiver of National Bank of Kentucky and National Bank of Kentucky, Appellants, v. American Bonding Company and Commissioners of the Sinking Fund of the City of Louisville, Appellees, to the end that this cause may be reviewed and determined by this Court, and that the decree of the said Circuit Court of Appeals for the Sixth Circuit be reversed on the grounds urged herein, and for such further relief as to this Court may seem proper.

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE,
Petitioner,

By LAWRENCE S. POSTON,
Counsel for Petitioner,
City Hall,
Louisville, Kentucky.

HAL O. WILLIAMS,
Louisville, Kentucky,
Of Counsel.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No.__________.

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE, - - - - - - - *Petitioner*,

v.

A. M. ANDERSON, RECEIVER, NATIONAL BANK OF KENTUCKY, AND
NATIONAL BANK OF KENTUCKY, - - - *Respondents.*

PETITIONER'S BRIEF ON PETITION FOR WRIT OF CERTIORARI.

OPINIONS AND DECREES BELOW.

The opinion and decree of the Circuit Court of Appeals for the Sixth Circuit reversing the District Court were rendered April 12, 1940 (Vol. II, R. 130-138 and R. 129 respectively), reported 110 F. (2d) 961.

The action was tried in the District Court for the Western District of Kentucky at Louisville, Judge Elwood Hamilton (now of the Sixth Circuit) then presiding. His opinion, filed July 21, 1937, is found in the record (Vol. I, R. 72-88) and reported 20 F. S. 217.

The decree was entered in the District Court October 9, 1937, and is found in the record (Vol. I, R. 100-108).

JURISDICTION.

Jurisdiction is conferred on This Court to review this cause by writ of certiorari by Section 240a of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A. 347a, 43 Stat. 938).

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

In rejecting the set-off the Circuit Court of Appeals has rendered a decision:

a. In conflict with applicable decisions of this Court upon a Federal question.

b. In conflict with the decisions of other Circuit Courts of Appeals on the same matter.

c. In a way probably in conflict with the decisions of the Court of Appeals of Kentucky.

d. In conflict with its own previous decisions creating confusion in the Circuit.

e. In which it has so far departed from the accepted and usual course of judicial proceedings as to call for exercise of this Court's power of supervision.

f. Which involves principles, the settlement of which is important to the public.

CONCISE STATEMENT.

In view of the summary statement shown in the foregoing petition (pp. 2-4), in the interest of brevity, same is not repeated here, and the Court is referred thereto, it being adopted as a part hereof.

THE ULTIMATE QUESTION.

Is the Commissioners of the Sinking Fund of the City of Louisville entitled to set-off, as against its deposits, the value of the City of Louisville bonds owned by the Bank, when it failed, or some part thereof?

Incidental and component questions are reflected in Specification of Errors.

SPECIFICATION OF ERRORS.

The United States Circuit Court of Appeals for the Sixth Circuit erred:

1. In rejecting the set-off.
2. In holding that the allowance of the set-off would result in an unfair distribution of the Bank's assets among its creditors.
3. In holding that as the bonds were unmatured at the date of insolvency, this prevented their use by way of set-off.
4. In holding that there was lack of mutuality and in holding that mutuality or interdependency or relation, was necessary.
5. In holding that our right of set-off was predicated on the redemption of the bonds, and in failing to distinguish between the equitable right of set-off and the value thereof.
6. In finding that practically all the bonds were pledged on the date on which the District Court adjudged that the Commissioners were entitled to their surrender, and that, therefore, set-off could not be allowed.

7. In finding that when the Bank closed, its City of Louisville bonds were selling above par.

8. In assumptions not supported by the record and not made the basis of findings of fact in the District Court.

9. In assumptions not based on findings of fact in the District Court.

10. In holding that the Commissioners did not in reality assert a right to set-off.

11. In holding that what the Commissioners sought is a forced sale to them of the bonds, selling above par.

12. In finding that the Receiver reacquired the pledged bonds with money that was a part of the Bank's general assets, and in holding that the bonds bear the character of general assets.

SUMMARY OF ARGUMENT.

The Commissioners of the Sinking Fund of the City of Louisville is entitled to set-off against its deposits in the National Bank of Kentucky, aggregating $858,952.48 when it closed, the sum of $169,200.00, being the par value of City of Louisville bonds owned by the Bank when it became insolvent, or some part thereof.

Insolvency of the party against whom a set-off is claimed is sufficient ground for equitable jurisdiction and interference.

Equitable set-off is allowed whether the demands arise out of the same or wholly disconnected or independent transactions, whether liquidated or unliquidated, and even though obligation to insolvent has not matured.

These principles apply against an insolvent National Bank and no preference or unfair distribution is thereby created, as it is only the balance, if any, after the set-off is deducted, which can justly be held to form part of the assets of the insolvent.

Where insolvency has intervened, equity has extended the right to an unmatured note, upon the theory that in good conscience one ought not to be required to pay a debt to his creditor, if he cannot ultimately compel the creditor to pay a debt due him, even where strict mutuality is lacking.

Our equitable right of set-off existed upon the closing of the Bank. Such equity was subject to the then existing equity of $58,057.71 in favor of the Federal Government on account of the pledge; the subsequent redemption of the bonds merely made our equity more valuable.

Commissioners of the Sinking Fund of the City of Louisville is the City of Louisville.

ARGUMENT.

In the Appellate Court the Bank contended, *inter alia,* that the set-off should not be allowed, because:

1. Allowance thereof would constitute a preference resulting in an unfair distribution of the Bank's assets among its creditors.
2. The bonds had not matured.
3. There was no relation between the deposits and the bonded indebtedness; in other words that set-off does not exist where the transactions are independent.
4. Nearly all the bonds were pledged when the Bank closed.

Keeping these points of the Circuit Court of Appeals and the Bank in mind, the Court will please notice, as we pass from case to case, how aptly they overcome the position of the Circuit Court of Appeals and the Bank.

In *Scammon* v. *Kimball,* 92 U. S. 362, this Court held that a private banker having insurance in a company rendered insolvent by the Chicago fire, by which the banker's insured property was consumed with the rest, had a right to set-off the amount of his insurance against money of the insurance company in his hands on deposit, although the insurance was not due at the time of the insolvency, becoming due afterwards, when the banker had performed all the conditions required by the insurance company in the premises. It is to be noted that there, there was absolutely no relation between the deposit and the insurance, the obligations were definitely independent, the one of the other, and this Court says (p. 367):

> "Whether the suit be one at law or in equity, set-off must be understood as that right which exists be-

tween two parties, each of whom, under an independent contract, owes an ascertained amount to the other, to set-off their respective debts by way of mutual deduction, so that, in any action brought for the larger debt, the residue only, after such deduction, shall be recovered."

In *Carr* v. *Hamilton*, 129 U. S. 252, in a suit by an insolvent insurance company to foreclose and sell mortgaged property, the insured was decreed a set-off for the reserve value of the policy, and therein this Court said (pp. 255-256):

"Natural justice and equity would seem to dictate that the demands of parties mutually indebted should be set-off against each other, and that the balance only should be considered as due. But the common law, for simplicity of procedure, determined otherwise, and held that each claim must be prosecuted separately. 'The natural sense of mankind,' says Lord Mansfield, 'was first shocked at this in the case of bankrupts, and it was provided for by 4 Anne C. 17, Section 11, and 5 Geo. II, C. 30, Section 28.' Green v. Farmer, 4 Burr. 2220, cited in 2 Story Eq. Jur., Section 1433. In pursuance of these old statutes, and of the dictates of equity, the principle of set-off between mutual debts and credits has for nearly two centuries past been adopted in the English bankrupt laws, and has always prevailed in our own whenever we have had such a law in force on our statute book; and it mattered not whether the debt was due at the time of bankruptcy or not."

In *Scott* v. *Armstrong*, 146 U. S. 499, the affairs of an insolvent national bank were in liquidation through receiver, and a question of set-off was involved. The litigation reached the Circuit Court of Appeals for the Sixth Circuit, which certified certain questions to this Court as

to the law. The first question was (and this is a very controlling question here) (p. 502):

> "Where a national bank becomes insolvent and its assets pass into the hands of a receiver appointed by the Comptroller of the Currency, can a debtor of the Bank set-off against his indebtedness the amount of a claim he holds against the Bank, supposing the debt due from the Bank to have been payable at the time of its suspension, but that due to it to have been payable at a time subsequent thereto?"

The answer was "Yes" and set-off was allowed. This Court said, among other things (p. 507):

> "The note in controversy did not mature until September 7, 1887, but the deposit to the credit of the Farmers' Bank was due for the purposes of suit upon the closing of the Fidelity Bank, as under such circumstances no demand was necessary. The receiver took the assets of the fidelity bank as a mere trustee for creditors, and not for value and without notice, and, in the absence of statute to the contrary, subject to all claims and defenses that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached.
>
> "The right to assert set-off at law is of statutory creation, but courts of equity from a very early day were accustomed to grant relief in that regard independently as well as in aid of statutes upon the subject."

In this decision this Court construes Revised Statutes, Section 5234 (12 U. S. C. A., Section 192), Revised Statutes, Section 5236 (12 U. S. C. A., Section 194), Revised Statutes, Section 5242 (12 U. S. C. A., Section 91) (Appendix 32-33), inhibiting preferences in distribution of assets of insolvent national banks, and says they do not destroy

liens or equities, and what passes as assets to the Receiver is the net balance after the equity is allowed; that the allowance of a valid set-off is not a preference. The language of the Court is (p. 510):

> "Where a set-off is otherwise valid, it is not perceived how its allowance can be considered a preference, and it is clear that it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent.
>
> "The requirements as to ratable dividends, is to make them from what belongs to the Bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the Bank."

In *North Chicago Rolling Mills Co.* v. *St. Louis Ore & Steel Co.*, 152 U. S. 596, this Court upheld the equitable right of set-off on an unliquidated demand based on a contract in existence at the time the additional proceedings were instituted.

In rejecting the decision of the lower Court to the effect that the unliquidated damages could not be the subject of set-off in equity any more than in law, and that the claim arose out of transactions distinct from the subject-matter of the suit in which a set-off had been claimed, this Court says (p. 614):

> "The material thing is that the contract (for the breach of which the claim for damages arises) was in existence when the garnishment process was served."

Dissipating the idea that there must be some dependency of the one demand upon the other, and the idea that there must be some connection between the two demands, this Court says (pp. 615, 616):

> "Cross demands and counterclaims, whether arising out of the same or wholly disconnected transac-

tions, and whether liquidated or unliquidated, may be enforced by way of set-off whenever the circumstances are such as to warrant the interference of equity to prevent wrong and injustice."

* * * * * * * *

"By the decided weight of authority it is settled that the insolvency of the party against whom the set-off is claimed is a sufficient ground for equitable interference."

This decision completely answers most of the contentions of the Bank here on its claim of lack of mutuality and the conclusions of the Circuit Court of Appeals.

In the case at bar the contract of the City to pay the Bank the bonds was in existence at the time the Bank closed; that the obligation of the City was not then due is not material.

The several points of law so decided by this Court have been followed by a number of decisions in the various Circuit Courts of Appeals.

In *Sinclair Refining Co.* v. *Midland Oil Company*, 55 Fed. (2d) 42 (C. C. A. 4) the right of set-off was refused because there was no insolvency of either of the parties. Therein the Court refers to the North Chicago case, *supra*, as the leading case in Federal Equity upon the subject of set-off where insolvency is involved, and subscribes to the principles therein to the effect that it is immaterial whether the cross demands arise out of the same or wholly disconnected transactions or whether liquidated or unliquidated, and that insolvency is a sufficient ground for equitable interference.

In *Gray, Receiver of Monongahela National Bank* v. *School Districts of the Burrough of Brownsville*, 67 Fed. (2d) 141 (C. C. A. 3) (certiorari denied 291 U. S. 660), is

found a case, the facts of which coincide with those at bar very closely; therein the District Court allowed the set-off, which was affirmed by the Circuit Court of Appeals. The Court cites the *Scammon, Scott* and *North Chicago* decisions of this Court, *supra,* and recognizes the well-established principle that insolvency of the party against whom a set-off is claimed is a recognized ground for equitable inquiry and on a proper showing for equitable interference.

In *Jennings* v. *Gary State Bank,* 74 Fed. (2d) 100 (C. C. A. 7) there was again involved a receiver for a national bank and a State bank, the latter of which sought to establish a set-off. The set-off claimed was allowed by the District Court, and in affirming same the Circuit Court of Appeals said (p. 101):

> "It makes no difference that the right of action of the closed Bank had not matured at the time said Bank was closed, if the set-off which is claimed was acquired before the closing of the Bank."

The case of *Scott* v. *Armstrong, supra,* is cited and quoted from, and following this, the Court subscribed to the doctrine that the allowance of the set-off could not be considered a preference, and that which at the time of insolvency belongs of right to the debtor, does not belong to the Bank.

In *First National Bank of Indianola, Ia.,* v. *Malone,* 76 Fed. (2d) 251 (C. C. A. 8), the Court was considering a question bearing upon the points which we have here, and in allowing the set-off, followed the decisions above cited from this Court and upheld the right of set-off of a deposit against the debt upon an unmatured note and where strict mutuality was lacking, the Court saying (p. 255):

> "The right of set-off in equity, against unmatured claims, even where strict mutuality is lacking, is based upon the Bank's insolvency.
>
> "Where insolvency has intervened, equity has extended the right to an unmatured note, upon the theory that in good conscience one ought not to be required to pay a debt to his creditor if he cannot ultimately compel the creditor to pay a debt due him."

The Court endorsed the principle that equitable set-off prevails whether the cross-demand arises out of the same or wholly disconnected transactions and whether liquidated or unliquidated.

In the instant opinion, the Circuit Court of Appeals says:

> "Practically all of the bonds in question were pledged to the United States on the date on which the District Court adjudged that the Commissioners were entitled to their surrender" (Vol. II, R. 136).

As this statement is used as a basis from which the Circuit Court of Appeals denies the set-off, that Court must have considered the finding as material. The assumption is not only unsupported, but is negatived, by the record, which shows that the bonds were sold in the fall of 1934 (Vol. I, R. 39-44); the opinion of the District Court was entered July 21, 1937 (Vol. I, R. 72-88); the decree of the District Court was entered October 9, 1937 (Vol. I, R. 100-108).

Another statement of the Court unsupported by the record is:

> "The Receiver has reacquired them with money that was a part of the Bank's general assets, and we think they should, in consequence, bear the character of general assets." (Vol. II, R. 136.)

The record is silent on the question with what money and just when the bonds were redeemed by the Receiver. The over-collateralization of $105,942.29 (the difference between the par value of the bonds pledged, $164,000.00, and the amount secured, $58,057.71) seems to refute the Court's conclusion about redemption from general assets. In any event general assets could not have been used in excess of $58,057.71 for redemption of the bonds. All the bonds involved, except $5,200.00 thereof, were pledged, when the Bank closed, and were thereafter redeemed by the Receiver and held by him free from any pledge agreement (Stipulation III, Vol. II, R. 91). Under the decisions of this Court, *supra,* our equitable right of set-off prevailed and attached to all the bonds upon the insolvency of the Bank, and this the Circuit Court of Appeals has ignored.

There is no pleading specifically relying upon this point; no request for finding of fact in regard thereto was made (Vol. I, R. 45-46, 47-48), nor is it mentioned by the Receiver in his reasons for conclusions of law requested relative to set-off (Vol. I, R. 56-57). The point is not mentioned in the opinion of the District Court (Vol. I, R. 72-88) and there is no finding of fact in regard thereto, nor exception thereon (Vol. I, R. 89-100).

In *Ellerbe* v. *Studebaker Corporation of America,* 21 Fed. (2d) 993 (C. C. A. 4), the situation was identically the same as here on the point just urged, and set-off was allowed, although the note was pledged at the time of the failure of the Bank and was subsequently redeemed by the Receiver; in passing upon that point the Circuit Court of Appeals said (p. 997):

> "and we do not think that it makes any difference that the note had been pledged to the Federal Reserve Bank

and was held by it as security at the time the Bank failed.

* * * * * * * *

Even though the note was held under a pledge at the time of the Bank's failure, as soon as it was redeemed by the Receiver it became subject in his hands to a set-off to the extent of the deposit standing to the credit of the maker upon the books of the Bank, just as though it had never been pledged.'' (Citing authorities.)

And the Court further says (pp. 997-998):

> ''The rule that the rights of the parties become fixed when the Bank closes its doors means that a debtor of the Bank cannot set-off a claim acquired after insolvency against a debt contracted before. It does not mean that he cannot set-off his deposit against a note owned by the Bank and collected by its Receiver merely because at the time of the Bank's failure, the note was held by another Bank to which it had been pledged as collateral.''

We do not contend that a demand may be acquired after insolvency and claimed as a set-off. It cannot be. When the Bank closed, it owed us money, our deposits, and we were obligated to it on our bonds; our right of set-off existed then; it was subject to the then existing equity of $58,057.71 in favor of the Federal Government on account of the pledge; however, under the *Ellerbe* case, just cited, upon redemption, and consequent extinguishment of the pledge, and with it the equity of the Federal Government, our right of set-off remained without any intervening equity. The Court of Appeals takes the position that our right to set-off is based on redemption of the bonds, but such is not the case. The set-off existed upon the insolvency of the Bank; the subsequent redemption of the bonds

merely made our equity more valuable. The Court has failed to distinguish between the right of equitable set-off and the value thereof. *Dakin* v. *Bayly*, 290 U. S. 143, is cited, but it does not militate against our contention. The decision in our case on this point conflicts with that of the 4th Circuit in the *Ellerbe* case, and the latter is much better reasoned, being based on this Court's rulings.

From the foregoing decisions of the various Circuit Courts of Appeals, it appears that there is a decided conflict between them and the 6th Circuit on the points which we have here involved.

In support of its conclusion that the allowance of the set-off here claimed would result in an "unfair distribution of the Bank's assets among its creditors," the Circuit Court of Appeals has relied upon *Springfield National Bank* v. *American Surety Company*, 7 F. (2d) 44 (C. C. A. 6), which in turn was predicated upon *U. S. Fidelity & Guaranty Co.* v. *Wooldridge, Receiver*, 268 U. S. 234. Neither touches the case at bar, top, side nor bottom. The facts are entirely different from those here. In the *Wooldridge* case the Railway Company was the depositor, the Guaranty Company had executed to it a depository bond; the Guaranty Company had also executed a fidelity bond to the Bank guarding against frauds of the President. The Bank became insolvent through the frauds of the President and closed its doors. The Guaranty Company paid the Railway Company the latter's deposits and took an assignment from the Railway Company. The Receiver of the Bank sued the Guaranty Company on the fidelity bond and the Guaranty Company endeavored unsuccessfully to set-off by subrogation or assignment the amount it had paid the Railway Company. The case furnishes a

splendid example of what this Court means by independent transactions. The lower courts gave judgment for the Receiver on the fidelity bond, and this was affirmed by this Court. All the courts recognized that the Guaranty Company, after the insolvency of the Bank, could not have bought a claim against the Bank and used it in set-off. This is a well established rule. This Court very properly inquired as to what the right of the Railway Company was, and it was perfectly clear that its right was only to share with other unsecured creditors in the assets of the Bank, of which the fidelity bond there in suit was a part. The Railway Company could never have urged the right to set-off its deposits as against the fidelity bond, or any set-off, as it owed the Bank nothing to be set-off. This Court further says that if the Railway Company had insured the honesty of the Bank's officers, the Bank might have off-set such obligation of the Company against its claim as a depositor.

In the case at bar, we have no such state of facts as presented in the *Wooldridge* case. Here the contest is strictly between a depositor and the Bank, each indebted to the other. At the date of insolvency, the Commissioners had on deposit with the Bank deposits aggregating $858,-000.00 plus, for which the Bank was indebted to it. The Bank owned the bonds of the City, which had to be paid through the Commissioners, and the Commissioners' deposits in the Bank were for the purpose of paying the City's obligations evidenced by its bonds. The bonds were a direct charge on the assets of the Commissioners. Several of the accounts covered segregated deposits allocated to pay some of the very identical issue of bonds that the Bank owned, as follows:

CITY OF LOUISVILLE BONDS.

Owned by Bank—Par Value	Series	Commissioners' Deposits
$20,000.00	Hospital 4½%	$41,002.36
25,000.00	Sewer 4% due 1947	58,930.91
5,200.00	School Imp. 5% dated 1922	84,954.71
(F. F., Vol. I, R. 93)		(F. F., Vol. I, R. 90)

There was also a deposit of the Commissioners shown in the General Fund Account of $166,275.99 (F. F., Vol. I, R. 90), to be ultimately used for the payment of City bonds. Had our deposits been less than the value of the bonds, can it be doubted that the deposits would have been set-off against our bonded indebtedness to the Bank, pledge or no pledge? The controlling facts in the case of *Springfield National Bank* v. *American Surety Company,* 7 Fed. (2d) 44 (C. C. A. 6), so far as we are able to determine, are on all fours with the *Wooldridge* case just discussed, and so are within the ruling thereof, as said by the Appellate Court therein. From the facts which we have just related, that appear in the case at bar, it is evident that the "lack of contact" in the *Springfield* case, does not exist here; there is considerable "color of connection" here between the deposits of the Commissioners and the bonds held and owned by the Bank.

To allow us the set-off contended for here would not eventuate in an unfair distribution of the Bank's assets among its creditors, because the Bank's assets in our case is the balance between the aggregate of our deposits and the value of the bonds, making the Bank here, in the washout, our debtor,—and so no assets of the Bank are involved, as was held in *Scott* v. *Armstrong,* 146 U. S. 499, and *Jennings* v. *Gary, Indiana State Bank,* 74 Fed. (2d) 100, *supra.*

It seems to us that in reaching its decision, the Circuit Court of Appeals treats the set-off as one at law and not in equity, and has utterly ignored the distinction between legal and equitable set-off, established in the decisions upon which we rely.

The Circuit Court of Appeals contends that as the bonds were unmatured at the date of insolvency, this fact has been held by some courts to prevent their use by way of set-off, citing in support *Armstrong, Receiver,* v. *Helm,* 13 Ky. L. R. 460. This is what is known in Kentucky as an abstract opinion, and therefrom it cannot be ascertained just what the controlling facts were, although it would appear that a third person, a surety, was urging the set-off of his principal's deposits, which is not the situation here; apparently so much thereof as is referred to by the Appellate Court here is dicta. The *Helm* opinion is one handed down by an intermediate court, the Superior Court of Kentucky, abolished shortly thereafter. It was not a court of last resort and appeals were permissible therefrom to the Court of Appeals of Kentucky; on the point referred to by the Appellate Court here, the Helm decision appears to conflict with one rendered by the Court of Appeals of Kentucky, in *Kentucky Flour Co., Assignee* v. *Merchants National Bank,* 90 Ky. 225, wherein the Court held in effect that where an insolvent debtor who makes an assignment for the benefit of creditors is indebted to a bank with which he has money on deposit, the Bank may apply the deposits as a credit on its debt, although the debt had not matured at the time the assignment was made,—the right of equitable set-off due to insolvency existing; that such did not result in inequitable distribution. The Helm decision by the Superior

Court of Kentucky was rendered before the decision of this Court in *Scott* v. *Armstrong,* 146 U. S. 499, *supra.*

In denying set-off here, the Circuit Court of Appeals is flying in the teeth of the decisions of this Court, of the courts of various circuit courts of appeals, of the Court of Appeals of Kentucky, and its own previous decisions.

In *Central Appalachian Co.* v. *Buchanan,* 90 Fed. 454, the Circuit Court of Appeals for the Sixth Circuit sustained the claim for set-off although based on unliquidated damages, holding: That the claim was unliquidated was no objection to set-off in a court of equity, if insolvency exists; that it was no objection that the claim asserted had not arisen when the Receiver was appointed, nor when he recovered his judgment, it being sufficient that the contract under which the set-off arose was in existence when the Receiver was appointed, the Court stating further that it would seem that under the law of Kentucky, there was a statutory right of set-off existing in respect to all demands arising out of contract, regardless of mutuality of credit, nor was equitable right of set-off limited to credits strictly mutual, if insolvency exist.

Geo. D. Harter Bank v. *Inglis,* 6 Fed. (2d) 841, was decided by the United States Circuit Court of Appeals (6) (certiorari denied, 269 U. S. 576), and the first question was whether the Harter Bank had the right to set-off the deposits against the unmatured note owing it. The right of set-off was sustained by the District Court and affirmed by the Circuit Court of Appeals (6), holding (p. 843):

> "Where insolvency has intervened, equity has extended the right to an unmatured note, upon the theory that in good conscience one ought not to be

required to pay a debt to his creditor, if he cannot ultimately compel the creditor to pay a debt due him."

The instant decision of the Circuit Court of Appeals is based upon a further misconception of facts as shown by this record, in finding that when the Bank closed, the bonds were selling above par (Vol. II, R. 132-133). It is fair to presume that the Bank in its shaky financial condition was making every endeavor to bolster up the value of its assets, —was in position to know the value of the bonds at the time of its insolvency,—that it was carrying the bonds in its assets at the highest possible market value then obtainable,—and upon examining the record, we find (Vol. II, R. 46, Ex. 13, offered Depo., Zurschmiede, R. 45) that the Bank was carrying these bonds in their investment ledger sheets at a book value of $147,910.00, excluding the $5,200.00 School Improvement Bonds, making the total value of bonds at the time of insolvency at the Bank's own valuation $153,110.00, against which we seek to set-off deposits to the extent of $169,200.00, a loss to the Commissioners of about $16,090.00; we do not profit by the allowance of the set-off, as contended by the Bank.

In view of the record, we do not agree with the Circuit Court of Appeals, nor the Bank as urged by it, that we have not in reality asserted a right of set-off. Had the set-off been allowed by the Bank and the bonds surrendered to us, it is fair to presume that they would have been cancelled, otherwise we would be in the absurd position of holding our own bonds and out of one pocket paying the interest thereon as it became due, and putting it right back in our other pocket; which would appear to be a work of supererogation. So far as having any bearing upon the law of this case, there is no distinction between

ordinary notes, city warrants, certificates of indebtedness, and city bonds; they are all written evidence of indebtedness; the bonds, on account of its security, being of a more glorified nature.

It is customary to deliver an obligation to a debtor when paid. Our right to acquire our bonds and apply the sinking fund thereon is given by Ky. Stat. 3010-9 (App., p. 32).

It is contended by the Bank that there is lack of mutuality because the deposits were in the name of the Commissioners of the Sinking Fund, whereas the bonds were the obligation of the City of Louisville, and that they are two different persons. The Appellate Court did not discuss the point. Commissioners of the Sinking Fund of the City of Louisville is the City of Louisville (Kentucky Statutes 3010-1, Appendix, p. 31); its deposits are the funds of the City of Louisville. The Sinking Fund is under the control and management of the Commissioners of the Sinking Fund, and shall be held and sacredly used for the payment of the principal and interest of the bonded debt of the City (Kentucky Statutes 3010-8, Appendix, p. 31). The Commissioners of the Sinking Fund of the City of Louisville has quasi public powers; it has but one function, and that is to gather in and conserve the funds of the City of Louisville for the purpose of meeting the bonded indebtedness of the City of Louisville, including the interest thereon. The Commissioners of the Sinking Fund has no capital stock and no stockholders, as in the case of private corporations. The bonds of the City which were owned by the Bank when it closed, were each issued under an ordinance of the City, made a charge on the Sinking Fund, and a tax levied to pay the principal and

interest (Ex. 24 to 29, inc., Vol. II, R. 73-90, offered Stipulation, Vol. II, R. 65-66). Upon referring to Exhibit 30 (Vol. II, R. 92-93, offered with Supplementary Stipulation of Fact, Vol. II, R. 91), the Court will find a copy of one of the bonds, the pertinent provisions of which read:

> "The City of Louisville, for value received, hereby promises to pay * * *
>
> "These bonds are exempt from all forms of taxation for municipal purposes of the City of Louisville, and are a charge upon the Sinking Fund of said City, and a tax is levied on all the property subject to municipal taxation in the City of Louisville sufficient to pay the principal and interest of said bonds and ordered to be annually collected and paid into the Sinking Fund of the City of Louisville to be used alone for the payment of said principal and interest."

Inasmuch as there are many national banks at this time throughout the country in receivership, and the principles herein involved may arise in various jurisdictions, the questions here urged are not only of interest and importance to the parties to this cause, but to many insolvent national banks now in receivership and their many depositors.

CONCLUSION.

The petition for review on writ of certiorari should be granted.

Respectfully submitted,

LAWRENCE S. POSTON,
Counsel for Petitioner.
City Hall,
Louisville, Kentucky.

HAL O. WILLIAMS,
Louisville, Kentucky,
Of Counsel.

APPENDIX.

KENTUCKY STATUTES.

Section 3010-1:

Sinking fund; commissioners; number and election.—The sinking fund to pay the bonded debt of the city is hereby continued as now established by law, and shall consist of the mayor, the president of the board of aldermen for the time being, and three persons to be chosen on joint ballot, as hereinafter directed, and they and their successors in office shall continue to constitute the "commissioners of the sinking fund of the city of Louisville," and by that name shall continue to have corporate powers and existence, may sue and be sued, and do and perform all things necessary to execute the duties required and powers given them by this act.

Section 3010-8:

Sinking fund; resources of; purposes for which it may be used.—The sinking fund shall be under the control and management of the commissioners of the sinking fund, and shall be held and sacredly used for the payment of the principal and interest of the bonded debt of the city. The general council shall have no power to pass ordinances to diminish the present resources of the sinking fund as now established until the debts of said city, now or hereafter charged or chargeable upon said fund are paid, but may pass laws to increase the said resources; and the whole resources of said fund from year to year shall be sacredly set apart and applied to the payment of the interest and principal of the city's debts chargeable on said fund, and to no other use or purpose until the whole of the debts of said city are fully paid and satisfied, including the present and any future indebtedness of said city. Nor shall any other bonds, nor interest thereof, be charged upon said fund, unless provisions are made for the payment thereof at the time of the charge, sufficient, in the opinion of the commissioners, to pay the same.

Section 3010-9:

Sinking fund; purpose for which it may be used; disposition of surplus.—The funds, estate and income belonging now or hereafter to said fund shall be and is vested in and be under the control and management of the board of commissioners for the purposes herein declared; and if injured, withheld or abstracted, said board of commissioners may sue for and recover the same or any part thereof in their corporate name. The said commissioners shall apply said fund to the payment of the city's debts chargeable on the same, when they can do so on fair terms; but whenever there shall be a surplus of said fund, which cannot be applied on fair terms to the extinguishment of said liabilities, the said commissioners may invest the same in bonds of said city, or for which it is bound, or bonds of the State of Kentucky, or in United States bonds.

FEDERAL STATUTES.

R. S. 5234, U. S. C. A. 12, Section 192 (relevant part):

Default in payment of circulating notes. On becoming satisfied, as specified in sections 131 and 132 of this title, that any association has refused to pay its circulating notes as therein mentioned, and is in default, the Comptroller of the Currency may forthwith appoint a receiver, and require of him such bond and security as he deems proper. Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct; and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders. Such receiver shall pay over all money so made to the Treasurer of the United States, subject to the order of the comptroller, and also make report to the comptroller of all his acts and proceedings.

R. S. 5236, 12 U. S. C. A., Section 194:

Dividends on adjusted claims; distribution of assets. From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held.

R. S. 5242, 12 U. S. C. A., Section 91:

Transfers by bank and other acts in contemplation of insolvency. All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 216.

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE, - - - - Petitioner,

versus

A. M. ANDERSON, RECEIVER OF NATIONAL BANK OF KENTUCKY, and
NATIONAL BANK OF KENTUCKY, - - Respondents.

PETITIONER'S REPLY BRIEF.

LAWRENCE S. POSTON,
Counsel for Petitioner,
City Hall,
Louisville, Kentucky.

HAL O. WILLIAMS,
Louisville, Kentucky,
Of Counsel.

WESTERFIELD-BONTE CO., INCORPORATED, LOUISVILLE, KY.

SUBJECT INDEX.

ALPHABETICAL TABLE OF CASES.

Kentucky Statutes.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 216.

Commissioners of the Sinking Fund of the City of Louisville, - - - - - - - *Petitioner*,

v.

A. M. Anderson, Receiver of National Bank of Kentucky, and
National Bank of Kentucky, - - - *Respondents.*

PETITIONER'S REPLY BRIEF.

We have examined Brief of Respondents in Opposition to Petition for Writ of Certiorari.

We find therein assumptions, in instances not supported by the record, in other instances contrary to the record, and we call the attention of the court thereto, whether considered material or immaterial, as argument is predicated thereupon.

Respondents state several times, in effect, that at the time of the closing of the Bank, the bonds were worth in excess of their face value, then selling above par, which misconception was indulged in by the Circuit Court of Appeals. The record is to the contrary, as we have shown on page 28 of our original brief.

It is further stated that the bonds were redeemed by the payment of $58,057.71 from general assets in the pos-

session of the Receiver, which point we have presented on pages 20-23 of our original brief. All that the record shows in regard to the redemption of bonds is contained in Paragraph III of the Supplementary Stipulation of Facts, R., Vol. II, 91; the material part of which says:

> "It is further agreed that since the closing of the National Bank of Kentucky, the bonds have been redeemed by the Receiver, and are held by him, free from any pledge agreement."

Thus the facts in regard thereto are meager. It does not state definitely when the redemption was effected, nor from what funds, nor that the sum of $58,057.71 was paid. Whether the bonds were ever in the possession of the United States Government does not appear. At best the bonds were simply security and did not cover any loan made by the Federal Government to the Bank.

In this connection we note respondents' statement that after the Bank closed, a dividend of 67% was paid to creditors and further that since this case was tried in the District Court, an additional 10% dividend has been paid. From this it is clear that the United States Government, like other depositors, has received 77% of its deposits from general assets, and there is left unpaid only 23% or $13,353.27, which means that in any event general assets have not been used in excess of $13,353.27, for redemption of the bonds.

Respondents state that the case is unique, and if this is so, we think such evidences splendid grounds for allowance of writ asked for. A situation that has arisen, may arise again.

Respondents' contention that we have not in reality asserted a right to set-off, is illusory and unsound.

It is based in part upon the assumption that had we acquired the bonds they were not to be cancelled, an assumption not supported by the record, and which point we have argued on pages 28 and 29 of our original brief.

This assumption is in line with that of the Circuit Court of Appeals to the effect that:

> "Had they not been redeemed, the Commissioners would never have contended that they were entitled to them."

Wherein the Circuit Court of Appeals, as well as Respondents, has delved into the realm of metaphysics and endeavored to read the mind of a corporation.

The contention is also based under the further assumption that at the time of the closing of the Bank, the bonds were worth in excess of their face value, contrary to the record, as hereinbefore shown.

Of necessity, where one of the parties is insolvent, its obligations are not worth dollar for dollar, but to deny the right of set off for that reason, means the ignoring of the principles of equitable set off enunciated by this court. If this argument of Respondents is sound, there is no such thing as equitable set off in cases of insolvency.

Respondents' statement that, *pendente lite,* the bonds sold at a premium of $4,312.25 is not accurate, as can be seen by referring to R., Vol. I, 40, which shows that the $173,512.25, for which the bonds sold, embraced principal and accrued interest—how much of each is not shown. If, as a matter of fact, the bonds did sell at a premium, this would not affect the principle involved; and if the court should hold that for the premium of the bonds, if any, we could not recover, this would be a simple matter of adjustment.

Respondents contend that a depositor-indorser of a note may only set-off his deposit against his obligation when the maker of the note is insolvent, and two cases are relied upon, to-wit:

1. *Bank of United States* v. *Braveman,* 259 N. Y. 65, 71, 181 N. E. 50.
2. *Willing* v. *Binenstock,* 302 U. S. 272, 276.

which rule is correct.

In the New York case set-off was not allowed because the maker of the endorsed note was perfectly solvent, the court recognizing that set-off was proper if the maker of the note was insolvent.

In the *Willing* case this court quoted from the New York case establishing the same principle, but in answer to the argument of respondents that by allowing the set-off here, we would receive a preference, we note that this court says in the *Willing* case that it held in *Scott* v. *Armstrong,* 146 U. S. 499, 510:

> "That the allowance of the valid set-off cannot be considered a preference, and that only the balance, after deduction of the set-off, constitutes part of the assets of the insolvent. 'The requirement,' the court said, 'as to ratable dividends, is to make them from which belongs to the Bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the Bank.' "

This is not a contest involving an endorser-depositor, with a solvent principal behind us or with indemnity. Here the City must pay its bonds through the funds handled by the Commissioners, so the decisions cited have no applicability here.

In contending that set-off was properly denied because the bonds were pledged at the time of the closing of the Bank, respondents state that:

> "Petitioner's counsel conceded in the lower Court that there would be no right of set-off had the bonds remained pledged."

We made no such concession.

Respondents proceed:

> "He contended, however, that such right of set-off was created by virtue of the redemption of the securities by the Receiver after the Bank closed."

We did not so contend. We do not predicate our right to set-off upon the redemption. This point is argued on pages 20-23 of our Original Brief.

Respondents cite the case of *United States Fidelity & Guaranty Co.* v. *Wooldridge*, 268 U. S. 234, to which we have paid our attention, on pages 23-25 of our Original Brief. They base their argument on this point on the theory that our right of set-off was based upon redemption, which it is not; nor do we concede that had the Receiver permitted the Government to sell the bonds and applied proceeds on the Postal Savings Fund Deposit, there would be no right of set-off. It has always been our contention that our right of set-off existed upon the closing of the Bank, which respondents consistently ignore.

Respondents cite three cases holding that rights can not be gained as a result of errors of the Receiver, to wit:

United States Shipping Board, et al., v. *Rhodes*, 297 U. S. 383.
LaParr v. *City of Rockford, Illinois*, 100 F. (2d) 564.
Granzow v. *Village of Lyons, Illinois*, 39 F. (2d) 83,

which principle is correct. By the same token could our right of set-off attaching when the Bank closed have been defeated by erroneous action of the Receiver in disposing of the bonds, in the manner suggested by Respondents? The decisions in those cases do not involve a question of set-off, and have no application here, because we do not have involved any illegal pledge or anything *ultra vires* or any mistake of law or error as obtained in those cases. Must we try a moot case?

This case must be tried on the facts hereof, not on theories, suppositions or unwarranted assumptions. As we have shown, the maximum amount of pledged bonds that could have been sold is $13,353.27.

Respondents contend that under the ordinances providing for these bonds the Commissioners of the Sinking Fund cannot pay them prior to maturity, but the ordinances quoted do not support such conclusion. As shown on page 29 of our Original Brief, our right to acquire our bonds and apply the sinking fund thereon is given by Kentucky Statute 3010-9 (Appendix, p. 32).

It is contended that set-off was properly denied because the obligation of the bank on account of the deposits and the obligation of the city on account of its bonds were wholly independent transactions and in support thereof the case of *United States Fidelity & Guaranty Co. v. Wooldridge*, 268 U. S. 234, is relied upon, and which we have thoroughly distinguished in our Original Brief, pages 23-25.

Respondents urge that set-off was properly denied because the bonds were obligations of the City of Louisville and the funds belong to the Commissioners of the Sinking Fund of the City of Louisville, a separate corporation, which point we argued on pages 29 and 30 of our Original

Brief. Respondents contend that the City of Louisville and the Commissioners of the Sinking Fund receive their powers by separate legislation and that the statutes which create the Commissioners of the Sinking Fund do not deal with the City itself. This contention is through misapprehension and it is incorrect.

If the point is of any importance, and the Court will refer to Baldwin's 1936 Revision of Carroll's Kentucky Statutes, it will find that Chapter 89-1 thereof, beginning with Section 2742, ending 3037L-14 has to do with municipal corporations of the first class (Louisville), and that Article XXVIII thereof, beginning with Sections 3010-1, ending 3024a-10, treats with the Sinking Fund.

The sections contained in the present compilation under Chapter 89-1 are evolved from the Acts of the General Assembly of Kentucky 1891-1892-1893; Chapter 244 thereof, beginning at Page 1265, is "An Act for the Government of Cities of the First Class." The Sinking Fund provisions pertaining thereto commence with Section 224 of that Act, Page 1329 of the compilation of these Acts, and if the Court will refer to said Section 3010-1 of the present compilation above referred to, it will find a notation to that effect. The Act of 1893 relative to the Sinking Fund was amended by the Act of March 22, 1902, Chapter 83, page 191 and other Acts.

Respondents cite case of *General Discount Corporation v. First National Bank—Detroit*, 5 F. S. 709 (1933), wherein Respondents liken the situation to that of a parent private corporation and its subsidiaries, private corporations. There is no analogy. In the case cited, the parent private corporation and the three subsidiary private corporations were each incorporated for separate and distinct

purposes; each of the subsidiary corporations was engaged in a different line of business; each had its own stockholders and Board of Directors, although to some extent overlapping.

Respondents cite the case of *Federal Deposit Insurance Corporation* v. *Casady,* 106 F. (2d) 784 (C. C. A. 10) (1939), and reported in 24 F. S. 687. Conclusion of Respondents to the effect that the City was held not to be the owner of the accounts for the purpose of determining the extent of the FDIC guarantee, is not supported by those decisions. The District Judge recites that at the time of the failure of the Bank, the *Town of Cheyenne* had five separate deposits in the Bank, and said that the question to determine is, "whether or not the *Town of Cheyenne* had five deposits or one deposit." The *FDIC* case did not involve a question of set off, and we do not see how the decision in any way affects the case at bar. Objections to the granting of the writ, are based upon assumptions sometimes not supported by the record, at other times contrary thereto, and upon decisions that do not control the questions here involved.

The petition for review on writ of certiorari should be granted.

Respectfully submitted,

Lawrence S. Poston,
Counsel for Petitioner,
City Hall,
Louisville, Kentucky.

Hal O. Williams,
Louisville, Kentucky,
Of Counsel.

No. 216

Supreme Court of the United States

OCTOBER TERM, 1940

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE,

Petitioner,

v.

A. M. ANDERSON, Receiver of the National Bank of Kentucky, and NATIONAL BANK OF KENTUCKY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

FRANK E. WOOD,
ROBERT S. MARX,
HARRY KASFIR,
Cincinnati, Ohio,
Attorneys for Respondent, A. M. Anderson, Receiver National Bank of Kentucky.

GEORGE P. BARSE,
Attorney for the Comptroller of the Currency.
Of Counsel.

THE JOHNSON & HARDIN CO., LAW PRINTERS
CINCINNATI, OHIO

SUBJECT INDEX

TABLE OF AUTHORITIES

No. 216

Supreme Court of the United States

OCTOBER TERM, 1940

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE,

Petitioner,

v.

A. M. ANDERSON, Receiver of the National Bank of Kentucky, and NATIONAL BANK OF KENTUCKY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE

The National Bank of Kentucky is insolvent and respondent A. M. Anderson is the receiver duly appointed by the Comptroller of the Currency.

The petitioner, the Commissioners of the Sinking Fund of the City of Louisville, is a corporation created and exist-

ing under and by virtue of Sections 3010-1 to 3024, inclusive, of the Kentucky Statutes.[1]

The City of Louisville is a separate and distinct corporation, and it receives its powers by separate legislation. The statutes which create the corporation known as "Commissioners of the Sinking Fund of the City of Louisville" do not deal with the city itself.

When the bank closed the Commissioners of the Sinking Fund of the City of Louisville (hereinafter called Sinking Fund Corporation) had a balance on deposit of $858,952.48. This balance was divided into the following accounts:

General Fund Account	$166,275.99
Sewer Bonds 1907 Issue	58,930.91
Sewer Bonds 1920 Issue	140,220.56
School Bonds 1922 Issue	84,954.71
Memorial Bonds 1924 Issue	27,018.56
Sewer Bonds 1925 Issue	127,632.08
Grade Crossing Bonds	138,489.18
Sewer Bonds 1929 Issue	46,116.40
Hospital Bonds	41,002.36
Louisville Water Co. 1906 Issue	14,135.73
Louisville Water Co. 1910 Issue	14,176.00
	$858,952.48

At that time the National Bank of Kentucky held in its portfolio the following securities, all of which were bond obligations of the City of Louisville:

---

1 Section 3010-1, Carroll's Kentucky Statutes reads:

"Sinking fund; commissioners; number and election.—The sinking fund to pay the bonded debt of the city is hereby continued as now established by law, and shall consist of the mayor, the president of the board of aldermen for the time being, and three persons to be chosen on joint ballot, as hereinafter directed, and they and their successors in office shall continue to constitute the 'commissioners of the sinking fund of the city of Louisville,' and by that name shall continue to have corporate powers and existence, may sue and be sued, and do and perform all things necessary to execute the duties required and powers given them by this act."

City of Louisville, 3½% 1903 Issue, maturity 1943	$ 14,000.00
City of Louisville Hospital, 4½% 1911 Issue, maturity 1951	20,000.00
City of Louisville, Refunding, 3½% 1901 Issue, maturity 1941	13,000.00
City of Louisville, Refunding, 3½% 1901 Issue, J. D., maturity 1941	53,000.00
City of Louisville, School Improvement Bonds, 5% 1922 Issue, maturity	5,200.00
City of Louisville, School, 4½% 1914 Issue, maturity 1954	10,000.00
City of Louisville, Sewer, 4% 1907 Issue, maturity 1947	25,000.00
City of Louisville, Sewer and Park, 3% 1901 Issue, maturity 1941	29,000.00
	$169,200.00

All of these bonds with one exception were pledged to the United States Government as collateral security for government deposits of postal savings funds. After the appointment of the receiver the bonds were redeemed by the payment of $58,057.71 from the general assets in his possession (R., Vol. II, 91). The bonds were selling above par and during the pendency of these proceedings they were sold for $173,512.25 or $4,312.25 in excess of their face amount (R., Vol. I, 40).

The bonds were carried in the investment ledger of the bank, the carrying value in some cases was below par and in others above par (R., Vol. II, 44-6). None of the bonds was purchased from the Sinking Fund Corporation or from the City of Louisville. They were all acquired in 1919 when the National Bank of Kentucky merged with the National Bank of Commerce (R., Vol. II, 44).

Each of the bonds contained a statement that "the City of Louisville for value received hereby promises to pay . . ." (R., Vol. II, 91-3).

It will be noted that the promise is only by the City of Louisville. There is no promise by the separate and distinct corporation known as "Commissioners of the Sinking Fund of the City of Louisville."

Shortly after the bank closed a dividend of 67% was paid to creditors (R., Vol. I, 92). Since this case was tried in the District Court an additional 10% dividend has been paid.

In the petition filed by the Sinking Fund Corporation claim was made for a preference to the full extent of the deposit and in the alternative the plaintiff prayed for an order requiring the Receiver to deliver the bonds to the Sinking Fund Corporation subject to a credit on the deposit of their face amount, $169,200.00.

The alternative demand was designated by the Sinking Fund Corporation as a "claim of setoff" and on that basis it attempted to obtain the bonds. The relief sought was denied and the present petition for writ of certiorari is addressed solely to the demand of the Sinking Fund Corporation for delivery of the bonds.

The prayer in the petitioner's bill of complaint reads (R., Vol. I, 14):

> "(1) For a judgment against the defendant, Paul C. Keyes, as Receiver of the National Bank of Kentucky, that the plaintiff is entitled to offset its account in the National Bank of Kentucky to the extent of One Hundred and Sixty-nine Thousand and Two Hundred Dollars ($169,200.00), of City of Louisville Bonds mentioned in the petition, that said offset be made as of the date of the closing of said Bank and *that said Keyes, as such Receiver, be ordered and directed to deliver to this plaintiff said One Hundred and Sixty-nine Thousand and Two Hundred Dollars ($169,200.00) City of Louisville Bonds* with interest coupons attached as of the date of said offset and if said interest coupons have been cashed, to deliver to this plaintiff the full amount of same in cash." [2]

[2] Emphasis throughout this brief ours unless noted otherwise.

ARGUMENT

No Ground for Allowance of the Petition for Writ of Certiorari Has Been Advanced by the Sinking Fund Corporation

Petitioner predicates its argument for allowance of the writ of certiorari on the assumption that the relief sought was a setoff of mutual accounts. Proceeding on this erroneous assumption it asserts that rulings of this court and decisions in other circuits have been disregarded.

However, the Court of Appeals did not depart from the well settled rules of setoff since no problem of setoff was presented under the facts. The court dismissed as irrelevant the cases relating to setoff relied upon by petitioner.

There are no special or important reasons presented by petitioner to justify the granting of certiorari. The case is unique, involving circumstances not likely to arise again, and of no general public interest.

Petitioner Seeks a Forced Sale to It of Assets of the Bank, Selling Above Par, at Their Face Value, the Consideration Therefor to be Cancellation of an Equal Amount of Its Deposit. A Forced Sale of Such Character Cannot Be Effected by Calling It an Alleged "Setoff"

Generally when a setoff is requested a situation is presented where parties have mutual claims and the court balances one claim against the other, cancelling them to this extent and allowing a claim to the extent of the balance due. No such balancing of mutual accounts for the purpose of determining the actual obligation was requested or desired by the Sinking Fund Corporation. It prayed for an order directing the receiver

> "to deliver to this plaintiff said $169,200.00 City of Louisville bonds with interest coupons attached."

The bonds were not to be cancelled. They were to continue as obligations of the City of Louisville. If the relief

desired had been granted the Sinking Fund Corporation could hold the bonds as assets of the Sinking Fund, collect interest thereon for that fund or sell the bonds on the market for any price obtainable. At the time of the closing of the bank the bonds were worth in excess of their face value and if the relief sought had been granted then the Sinking Fund Corporation would have acquired the bonds with its depreciated deposit and it could have sold them for an amount in excess of their face value. The Sinking Fund Corporation would not only secure payment of its deposit in full but it would also profit out of the failure of the bank to the extent of the amount realized on the sale of the bonds in excess of their face value. The Sinking Fund Corporation did not seek to cancel mutual obligations but attempted to use its deposit in the bank to invest in securities. During the pendency of these proceedings the bonds were sold for $173,512.25, or $4,312.25 in excess of their face amount. If the Sinking Fund Corporation had been successful in requiring the receiver to deliver the bond it would have realized this profit of $4,312.25.

The $169,200.00 on deposit, which the Sinking Fund Corporation desired to set off against the bonds, was only worth $113,364.00 at the time the bank closed. This is based on the fact that the receiver was then paying a 67% dividend. Under the petitioner's claim the Sinking Fund Corporation could use this deposit worth $113,364.00 to acquire investments which had a face value of $169,200.00 and an actual value of $173,512.25. The Sinking Fund Corporation would not only have received a preference but would have benefited as a result of the failure of the bank while other depositors were only receiving 67% of their deposits.

A depositor is not permitted to benefit by exercising the right of setoff. This is illustrated by the rule that an endorser of a note may only set off his obligation against his deposit when the maker of the note is insolvent. No setoff

is permitted when the maker is solvent since "such a result would be inequitable." *Willing* v. *Binenstock*, 302 U. S. 272, 276, quoting from *Bank of United States* v. *Braverman*, 259 N. Y. 65, 71, 181 N. E. 50.

If the Sinking Fund Corporation had received the same bonds as a pledge for the repayment of its deposit, assuming such pledge was proper, and if the pledged assets had been sold after the bank closed, the Sinking Fund Corporation would only be permitted to retain so much of the sale price as would pay off its deposit. The excess would go to the receiver for the benefit of the depositors. Under the relief sought by the petitioner, however, it would not only have the benefit of a pledge which never existed but it would become possible for the petitioner to profit to the extent of the excess value of the bonds over the face amount.

In pointing out that setoff was not involved, the court of appeals said (R., Vol. II, 136):

> "We are of the opinion not only that the Commissioners have no right to a setoff, but that they have not, in reality, asserted such a right. What they have sought is a forced sale to them of the City's unmatured bonds, selling above par, at their face value, the consideration therefor being cancellation of an equal amount of the insolvent Bank's indebtedness. The right of setoff involves only a cancellation of mutual indebtedness. Cf. *Scammon* v. *Kimball*, 92 U. S. 362."

The Relief Sought Was Properly Denied Because the Bonds Were Pledged at the Time of the Closing of the Bank

Petitioner's counsel conceded in the lower court that there would be no right of setoff had the bonds remained pledged. He contended, however, that such right of setoff was created by virtue of the redemption of the securities by the receiver after the bank closed. This is a claim that a right of setoff which did not exist as of time of insolvency

could be created by subsequent action of the receiver. The rights of all parties were fixed when the bank closed. The right of setoff being governed by the state of things existing at the moment of insolvency (*U. S. Fidelity & Guaranty Co.* v. *Wooldridge*, 268 U. S. 324), subsequent events cannot create a right of setoff which did not exist at the time of failure.

The decision in *Ellerbe* v. *Studebaker Corporation of America*, 21 F. (2d) 993 (C. C. A. 4, 1927), relied upon by petitioner, is clearly distinguishable from this case on the facts, and in any event is not in conformity to the principles laid down by Mr. Justice Holmes speaking for this court in the *Wooldridge* case, *surpa.*

If the argument of the petitioner is correct the depositors of the bank would have been in a better position if the receiver had permitted the U. S. Government to sell the bonds and apply the proceeds on the postal savings fund deposit. It is conceded that if this procedure had been taken there would be no setoff. Rights cannot be gained as a result of errors of the receiver [*U. S. Shipping Board et al.* v. *Rhodes*, 297 U. S. 383; *La Parr* v. *City of Rockford, Ill.*, 100 Fed. (2d) 564; *Granzow* v. *Village of Lyons, Ill.*, 89 Fed. (2d) 83], and his use of depositors' money to redeem the bonds cannot create a right of setoff which did not exist when the bank closed and would never have existed if the receiver had required the government to exercise its rights under the pledge arrangement to recover its deposit.

> "Had they (the bonds) not been redeemed, the Commissioners would never have contended that they were entitled to them. The receiver has re-acquired them with money that was a part of the bank's general assets, and we think they should, in consequence, bear the character of general assets. Morever, we think, as did the receiver, that any claim the Commissioners may have as to these bonds must have existed when the

bank failed; they can acquire no right as a result of the receiver's decision to redeem the bonds instead of allowing the government to sell them to satisfy the bank's debt." (Opinion Court of Appeals, R., Vol. II, 136.)

The Sinking Fund Corporation Has No Right to Mature the Bonds and There Are No Mutual Obligations to Cancel

The Court of Appeals concluded that "the right of set-off involves only a cancellation of mutual indebtedness." Petitioner neither prayed for cancellation of the bonds nor was in a position to cancel them. The bonds were unmatured. Petitioner relied on Section 3010-9, Carroll's Kentucky Statutes, as authority for accelerating the maturity date. The section reads in part:

> "The said Commissioners shall apply said fund to the payment of the city's debts chargeable on the same, when they can do so on fair terms; but whenever there shall be a surplus of said fund, which cannot be applied on fair terms to the extinguishment of said liabilities, the said commissioners may invest the same in bonds of said city, or for which it is bound. . . ."

Since the Sinking Fund Corporation was asking for delivery of the bonds and not their cancellation it was not attempting to apply the funds in the payment of the city's debts. It was attempting to acquire securities which would continue to be outstanding obligations. The city would still be liable for interest. The purchaser would be in a position where it could sell the bonds when it was advantageous to do so. This certainly is not an acceleration of the maturity date. It is not striking a balance between parties having mutual obligations. Setoff does not permit one party to acquire a salable investment which can be used by that party to profit at the expense of the depositors of the bank.

The right of the petitioner to accelerate the bonds is limited by statute and by the ordinances under which the bonds were issued. The ordinances provide that the Sinking Fund Corporation should collect a special tax for payment of the bonds which,

> "shall be set apart by the Commissioners of the Sinking Fund of the City of Louisville and safely invested so as to yield interest, and the sinking fund arising therefrom shall be preserved and used alone for the payment of the principal of said bonds at maturity." (R. Vol. II, 74.)

The Sinking Fund Corporation cannot pay the bonds prior to maturity.[3]

The Relief Sought Was Properly Denied Because Acquisition of Bonds by the National Bank of Kentucky and Deposit of Funds by the Sinking Fund Corporation Were Two Wholly Independent Transactions and Were Not Brought Into Mutual Account by Any Agreement of the Parties

The bonds were acquired by the bank in 1919. Petitioner did not know that the bank owned the bonds. Therefore its deposits were made without reliance on the bank's ownership of these bonds as a means of payment of the account. The fact that the acquisition of the bonds by the bank and the deposits by the Sinking Fund Corporation were wholly unrelated is a bar to setoff even if setoff had been prayed for. *Scott* v. *Armstrong*, 146 U. S. 499, 507; *U. S. Fidelity & Guaranty Co.* v. *Wooldridge*, 268 U. S. 234.

---

[3] See Ordinance 198 covering the issuance of the $29,000.00 worth of bonds in 1901, pursuant to ordinance adopted in 1900 (R., Vol. II, 73). Ordinances as to the other issues containing similar language appear in the record (R., Vol. II, 75-90).

The Relief Sought Was Properly Denied Because the Bonds Are Obligations of the City of Louisville and the Funds Belong to the Commissioners of the Sinking Fund of the City of Louisville, a Separate Corporation

Each of the bonds was an obligation of the City of Louisville. They were not obligations of the Sinking Fund Corporation. The deposits belong to the petitioner. Under the statutes of Kentucky the funds of the two corporations were separately deposited.[4]

Deposits by the Sinking Fund Corporation are covered by Section 3010-12, Carroll's Kentucky Statutes.[5]

The relationship between the two corporations can be compared to the relation between a parent and subsidiary corporation. Obligations of a subsidiary corporation cannot be offset against deposits of the parent corporation and vice versa. *General Discount Corporation* v. *First National Bank-Detroit,* 5 Fed. Supp. 709 (1933).

Even when a sinking fund is under the direct management of the city treasurer and not separately incorporated, a deposit of sinking fund money is recognized as distinct and independent from general funds of the city and other special deposit accounts. Thus in *Federal Deposit Insurance Corporation* v. *Casady,* 106 F. (2d) 784 (C. C. A. 10, 1939), the court held the Federal Deposit Insurance Corporation to a liability up to Five Thousand ($5,000.) Dollars for each of the city's various accounts such as the

---

[4] Carroll's Kentucky Statutes, Sec. 2903.

"Bank selected annually for current deposits.—The mayor, comptroller and treasurer, and when the offices of comptroller and treasurer shall have ceased to exist, as provided by this act, the mayor and director of finance shall annually select a bank or banks, or banking institutions, which will give the highest rate of interest for the current deposit of the city's funds, and which shall give and maintain a bond, to be approved by said city officials, said bond to be conditioned for the safekeeping and prompt payment of said funds, or any part thereof, when demanded by the treasurer or director of finance, as the case may be."

[5] "The commissioners of the sinking fund shall deposit the funds in their hands as commissioners in some incorporated bank, state or national, located or doing business in said city. The bank selected by the commissioners aforesaid shall give bond with good and sufficient security to secure the said commissioners the payment of all moneys and other things of value deposited by them with such bank."

sinking fund account, the paving fund account, the firemen's pension fund account, etc. The court decided that the sinking fund money was held in trust by the city treasurer for bondholders and judgment creditors. The city was held not to be the owner of the account for the purpose of determining the extent of the F. D. I. C. guarantee.

CONCLUSION

Setoff Will Not Be Permitted Where Preference and Unfair Advantage Results

The ruling in the lower court denying relief was a denial of preference and a denial of the right of the petitioner to secure possession of bonds worth in excess of par in exchange for its depreciated deposit.

Petitioner's reliance for allowance of the writ is based on a claim of conflict with decisions of this Court and rulings by other circuits, the Court of Appeals of Kentucky, and prior rulings by the Court of Appeals for the Sixth Circuit. It is also claimed that there is a departure from the usual course of judicial proceedings and that the case involves important principles.

The entire contention is based on the assumption that the problem of setoff was presented. The cases cited involving actual setoff, however, were cases where there was an attempt to secure a balancing of mutual accounts. Such a case was not presented here and the decisions mentioned by petitioner are not in conflict with the ruling made by the Court of Appeals.

We respectfully submit that the writ of certiorari should be denied.

Frank E. Wood,
Robert S. Marx,
Harry Kasfir,
Cincinnati, Ohio,
Attorneys for Respondent,
A. M. Anderson, Receiver
National Bank of Kentucky.

George P. Barse,
Attorney for the Comptroller
of the Currency.
Of Counsel.